EASTERN EUROPE'S OIL TRADE

ALL UNCLASSIFIED SOURCES

Introduction

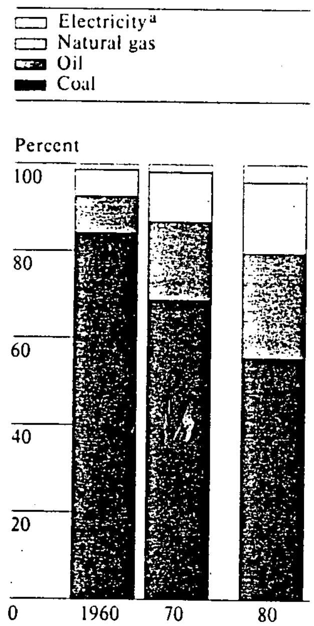
After sharply increasing imports of oil in the 1960s and 1970s, Eastern Europe now faces the problem of tighter oil supplies. The USSR, which had covered nearly all of Eastern Europe's growing oil demand on very favorable terms, has reduced since 1982 the volume of deliveries to most of its allies, and more cutbacks may be in the offing. The East Europeans are also burdened by steadily rising Soviet oil prices, which have now surpassed world market levels. Recently, Eastern Europe has increased moderately its imports of OPEC oil, but little of these deliveries seem destined for domestic use. Instead, the East Europeans are brokering the oil to generate much needed hard currency. Because of financial problems and the instability of its main OPEC suppliers, Eastern Europe is unlikely to rely over the long-term on non-Soviet sources to offset entirely the reduced volume of imports from the USSR.

The Rise of Oil Imports

Between 1960 and 1980, Eastern Europe reduced its reliance on domestic coal and stepped up consumption of oil. Over this period, coal's share in primary energy consumption fell from nearly 85 percent to 55 percent while oil's share rose from a little over 8 percent to nearly a quarter (see Figure 1).

STAT

Figure 1
Eastern Europe: Primary Energy Consumption by Fuel



[a] Includes hydro and nuclear power
[b] Projected.

Eastern Europe accomplished this change in its energy mix largely through a dramatic rise in oil imports (See Figure 2 and Table 1). Only Romania had significant domestic supplies of oil, and even it began to boost imports sharply over the latter half of the 1970s as domestic production declined because of dwindling reserves. Thus, Eastern Europe's net oil imports of just 40,000 barrels per day (b/d) in 1960--about 1 percent of primary energy consumption--climbed to over 1.7 million b/d by 1980 or one-fifth of primary energy consumption.

The Soviet Union was the chief source of the oil import surge. By 1980, net imports of Soviet oil were running at a rate of almost 1.6 million b/d, accounting for well over 90 percent of the region's total net imports of oil and about two-thirds of total energy imported from the Soviet Union. This increase in oil imports contributed heavily to the region's growing energy dependency on the USSR (see Figure 3). Not only did Soviet oil deliveries rise substantially, but the terms provided Eastern Europe were quite favorable. The Soviets did not raise oil prices to Eastern Europe during the first OPEC price explosion in 1973-74 and since 1975 have based prices on average world prices for the preceding five years. Moreover, Eastern Europe did not have to pay for Soviet oil in hard currency and the Soviet Union tolerated large trade deficits once the CMEA price began to rise. This arrangement essentially shielded most of Eastern Europe from oil price shocks while providing a continuing subsidy as world oil prices rose.

Figure 2
Eastern Europe: Oil Consumption and Crude Oil Imports

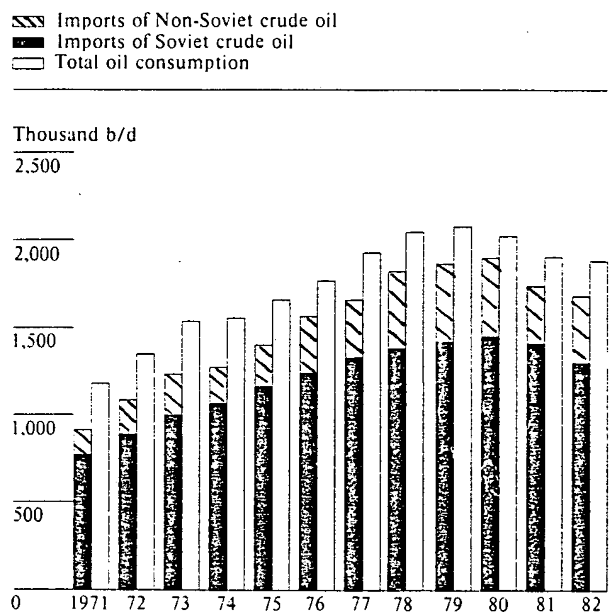


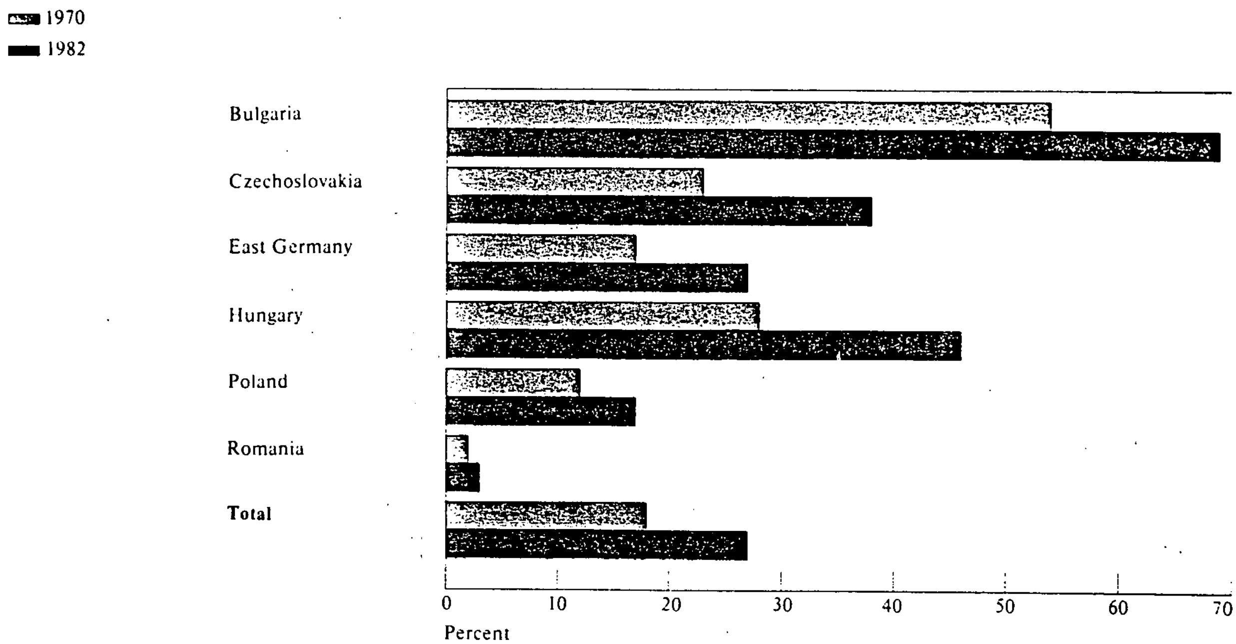
Table 1

EAST EUROPEAN OIL BALANCES
(thousand barrels per day)

	1960	1970	1975	1980	1983[1]
Apparent Consumption	317	1072	1661	2039	1821
Production	277	340	363	295	296
Imports	208	941	1555	2119	1830
Exports	168	209	257	375	305
Net Imports	40	732	1298	1744	1525

[1]Preliminary Estimate

Figure 3
Eastern Europe: Energy Imports from the USSR as a Share of Total Energy Consumption



Thus, non-Soviet oil never played much of a role in Eastern Europe's switch to oil except in the case of Romania. Some of the countries had relatively ambitious plans for OPEC oil but these plans were dashed with the second oil price explosion in 1979 and the economic slowdown in the region, which lessened the demand for energy. Excluding Romania, non-Soviet crude oil imports by Eastern Europe peaked at only 182,000 b/d in 1978, accounting for less than 11 percent of total oil imports and just 3 percent of primary energy consumption.

Romania, on the other hand, sharply boosted oil imports from the Mideast and North Africa in the latter half of the 1970s. With domestic production peaking in 1976 at 294,000 b/d, Bucharest needed oil to feed its growing refining industry. Crude oil imports jumped to 319,000 b/d by 1980, triple the 1975 level, and provided nearly 60 percent of Bucharest's oil needs (consumption plus exports). Well over one-half of these imports came from just three countries: Iran, Iraq, and Libya. During this period, Romania bought small amounts of Soviet oil in an effort to diversify its suppliers, but received no financial breaks.

Oil Problems Develop

Eastern Europe's access to adequate amounts of cheap Soviet oil came to an abrupt halt in the early 1980s. The region entered the current 1981-85 plan period expecting annual deliveries of oil from the Soviet Union generally to be held constant at the 1980 level. Yet the region's energy picture worsened in the fall of 1981 when Moscow informed most of the countries that it would reduce concessionary oil deliveries beginning in 1982 and probably continuing through at least 1985. Annual deliveries to Czechoslovakia, East Germany, Hungary, and possibly Bulgaria were cut by around 10 percent, or by approximately 40,000 b/d each to Prague and Berlin, 30,000 b/d to Sofia, and less than 15,000 b/d to Budapest. (Czechoslovakia and East Germany may have made up for part of the cutbacks by additional purchases at non-concessionary prices. It is still unclear to what extent deliveries to Bulgaria were actually cut.) The USSR apparently maintained deliveries to Poland because of its precarious economic and political situation. Warsaw reported only a minimal drop in Soviet deliveries of crude oil in 1982. Romania also was not affected by this change of policy because it never enjoyed the favorable terms offered to the rest of Eastern Europe. Bucharest has always paid world market prices in hard currency or hard goods for the small quantities of Soviet oil it has purchased. Bucharest, nonetheless, cut back purchases because of its hard currency crunch, reducing its imports of Soviet oil from as estimated 54,000 b/d in 1981 to just 7,000 b/d in 1982.

The rationale for the cuts is unclear, but the Soviets' need for increased hard currency exports probably was a major factor. Moscow also may have believed that the East Europeans could absorb the oil reductions without jolting their economies. In fact, the countries singled out by the USSR had substantially boosted oil product exports to the West in 1980-81 compared with 1979.

-- East Germany had doubled its oil product exports to over 80,000 b/d by 1981;

-- Czechoslovakia also boosted exports sharply to over 20,000 b/d in both 1980 and 1981;

-- Hungarian exports were up by over 40 percent to around 18,000 b/d in 1981; and

-- Bulgaria, whose oil product exports were minimal during most of the 1970s, exported some 30,000 b/d in 1980-81.

A Turn to OPEC?

With the reduction in Soviet deliveries and the soft world market for oil, several East European regimes have looked to OPEC for more oil. Most of the oil, however, does not appear destined for domestic use. Rather the regimes are reselling OPEC oil--in place of Soviet oil--to generate hard currency.

East Germany has kept active in the export market through a comparatively high level of non-Soviet oil imports--around 80,000 b/d in 1983. For example, East Berlin reportedly has resold Iraqi oil it received in a barter agreement with Baghdad. Hungary concluded an arrangement with Iran in late 1982 that increased crude oil imports by 20,000 b/d and Budapest, in turn, boosted oil exports. More recently, Bulgaria, Hungary, and Poland have been reselling substantial amounts of Libyan crude oil. During January-June 1983, the three countries imported an estimated 60,000 b/d from Libya compared with almost nothing during the same period of 1982. Polish and Hungarian oil exports for hard currency, in turn, tripled while Bulgaria sales increased at a slower pace. The Poles announced that their imports have come from a $230 million credit given in oil. Bulgaria and possibly Hungary may have received their oil as repayment for past credits extended to Tripoli--the Bulgarians and the Hungarians have run sizable trade surpluse with Libya in recent years. Some market observers, however, believe that the Hungarians may have obtained at least some of their oil on 360 days credit and resold it for cash.

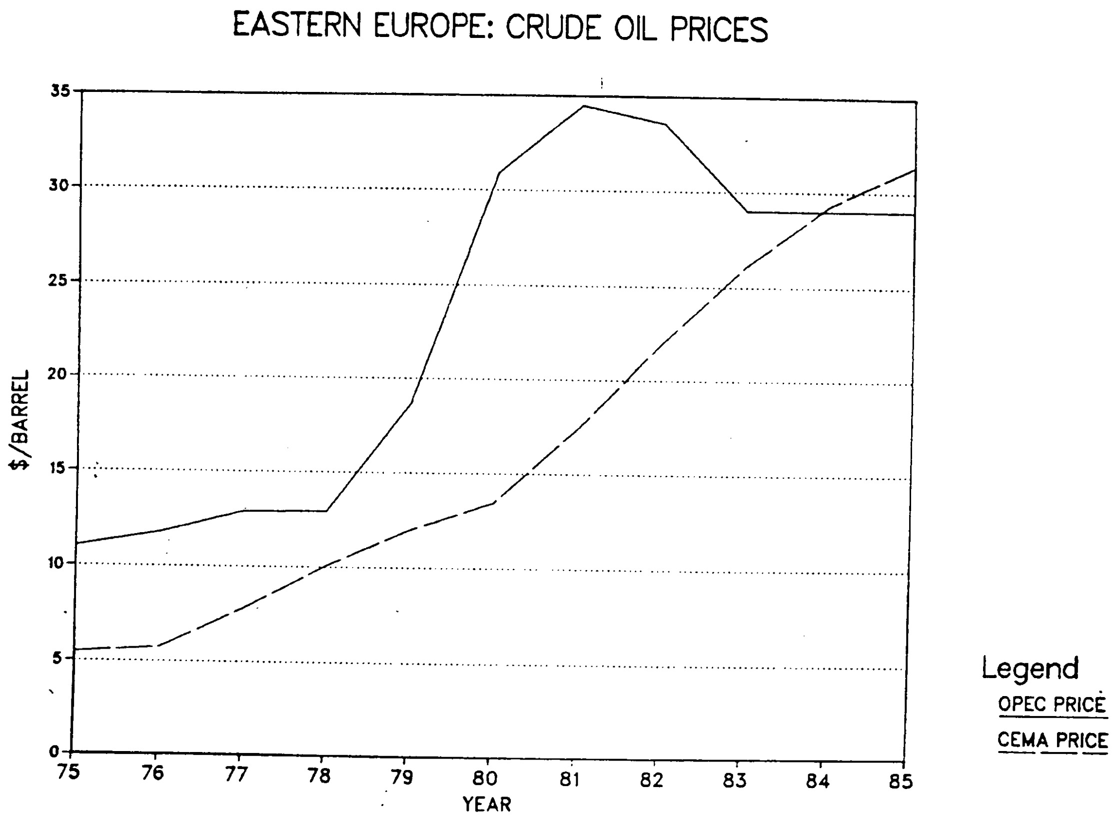
Czechoslovakia and Romania have been less active in the world oil market. Czechoslovakia apparently is keeping its annual OPEC purchases to less than 10,000 b/d per year and is not exporting much, perhaps a reflection of its relatively comfortable financial positon. Romania, which saw its crude oil imports drop 35 percent in 1981-82, is likely to keep imports down as long refining and reselling remain financially unattractive.

Outlook

The East Europeans cannot expect a reversal of Moscow's 1982 cutback in oil deliveries, and indeed they must anticipate further reductions. Moscow's need for hard currency sales as well as domestic production problems could well result in the Soviets cutting deliveries to Eastern Europe again in the near future. In addition, the East Europeans are no longer receiving a price break from Moscow since the CMEA moving average formula has continued to rise while the world market price has fallen from its 1981 peak. The CMEA price for crude oil rose to over 90 percent of the world market price in 1983 and has surpassed the world market price this year on the basis of the 5-year moving average pricing formula (see Figure 4). Thus, Eastern Europe must increase the volume of its exports to the USSR--including a possible diversion of goods from hard currency exports--to maintain imports of Soviet oil and other key commodities.

The East European may be paying an even heftier price to the USSR than that shown in Figure 4. Some Western observers believe that the CMEA pricing formula for oil may have been changed from one based on an average of world market prices for the preceding five years to one using only the preceding three years. This would result in a 24 percent jump in the Soviet oil price in 1984 compared with 12 percent under the five-year formula. Press reports in the past couple of months have cited a West German study which claims that East Germany has been paying for Soviet oil using a three-year moving average since 1982. The West German study may have arrived at this conclusion by dividing the ruble value of Soviet oil delivered to East Germany in 1982 by the volume reported in the East German press, which results in a unit price close to one derived from a three-year moving average. There is little evidence, however, to suggest that other East European countries are paying according to a three-year moving average. For example, energy price series from

Figure 4


EASTERN EUROPE: CRUDE OIL PRICES
35
30
25
20
15
10
5
0
$/BARREL
75
76
77
78
79
80
81
82
83
84
85
YEAR
Legend
OPEC PRICE
CEMA PRICE

Poland and Hungary for 1983 suggest that the five-year moving average is still in effect for these two countries.

Despite the current rash of activity in the hard currency oil market, Eastern Europe is unlikely to keep increasing imports from OPEC. Current trade largely involves Iran and Libya, both of whom are relatively unstable suppliers. In addition, East European goods traded for oil are likely to receive stiff competition as the West becomes more actively involved in barter agreements. Sizeable hard currency purchases from other sources are unlikely. The outlook for the Eastern Europe's hard currency import capacity remains poor because of sluggish export growth, large debt service obligations for some countries, and poor borrowing prospects.

In sum, Eastern Europe's oil trade is unlikely to pick up from current levels over the next couple of years. Net imports of oil probably will remain at around the 1.5 million b/d mark. Any further loss in imports--whether it comes from additional Soviet cuts or reduced supplies from OPEC--will likely be countered with reduced exports. Moreover, if the East European regimes attempt to revive economic growth, domestic oil needs will have to be met at the expense of oil exports.